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In The

Supreme Court of the United States

October Term, 1995

J. GEILS BAND EMPLOYEE BENEFIT PLAN, JOHN GEILS, JR., STEPHEN BLADD, RICHARD SALWITZ and SETH JUSTMAN,

Petitioners,

vs.

SMITH BARNEY SHEARSON, now known as SMITH BARNEY INC., MATTHEW McHUGH and KATHLEEN HEGENBART,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the First Circuit

RESPONDENTS' BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the First Circuit's interpretation of the "except in cases of fraud or concealment" clause of 29 U.S.C. § 1113 conflicts with the decision of the Seventh Circuit in *Wolin v. Smith Barney Incorporated*, 83 F.3d 847 (7th Cir. 1996).

2. Whether 29 U.S.C. § 1113 embraces a version of the doctrine of equitable estoppel which would excuse a plaintiff from exercising due diligence to discover his claim.

PARTIES INVOLVED

The parent company and subsidiaries (excluding wholly-owned subsidiaries) of Smith Barney Inc. are listed below.[1]

1. Parent Company:

   Travelers Group, Inc.

2. Subsidiaries:

   Institutional Property Owners, Inc. III

   Smith Barney Acquisition Fund, Inc.

   Smith Barney Commercial Corporation Asia Limited

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1. Although Lehman Brothers, Inc. is a separate corporate entity, it has a financial interest in the outcome of this case. If Smith Barney is found liable, Lehman Brothers will be partially responsible for any liability.

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Smith Barney Shearson, now known as Smith Barney Inc. (hereinafter "Smith Barney"), Matthew McHugh, and Kathleen Hegenbart respectfully oppose the Petition for a Writ of Certiorari to review the judgment of the United States Court of Appeals for the First Circuit in this case.

OPINIONS BELOW

The petitioners commenced arbitration proceedings with the National Association of Securities Dealers, Inc. ("NASD") in connection with certain investment transactions they made in 1985, 1986 and 1987, by filing a Uniform Submission Agreement dated August 20, 1993. Record Appendix: Volume I at pp. 92-94.[2] On motion by the respondents, the NASD Director of Arbitration ruled on May 5, 1994 that virtually all claims were ineligible for arbitration under Section 15 of the NASD Code of Arbitration Procedure since all trades giving rise to the claims occurred more than six years prior to the filing of arbitration. App. Vol. I, p. 74.

On October 7, 1994, petitioners commenced this action in the United States District Court for the District of Massachusetts by filing a complaint alleging violations of ERISA by respondents in connection with the same trades complained of in the NASD proceeding. App. Vol. I, pp. 9, 18. Respondents filed an Answer and Counterclaim for Declaratory Judgment and a Motion for Summary Judgment as to the Complaint and Counterclaim. App. Vol. I, pp. 81-115. Pending disposition of the outstanding motions, petitioners requested panel review of the decision of the NASD Director of Arbitration. On January 10, 1995, the arbitration panel affirmed the Director's ruling. App. Vol. I, p. 244.

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2. References to the Record are to the Appendix filed in the Court of Appeals for the First Circuit and will be referred to as "App. Vol __, p. __"

By an unpublished Memorandum and Interlocutory Order dated May 9, 1995, the district court allowed respondents' motion for summary judgment holding that the claims were barred by the statute of limitations. A copy of this Memorandum is reproduced in the appendix to the petition at A-32. After voluntary dismissal of respondents' counterclaims without prejudice, the court entered a final judgment dismissing the petitioners' claims on June 23, 1995.[3] App. Vol. II, p. 557.

On February 20, 1996, the United States Court of Appeals for the First Circuit affirmed the judgment of the district court in an opinion published as *J. Geils Employee Benefit Plan v. Smith Barney Shearson, Inc.*, 76 F.3d 1245 (1st Cir. 1996), and reproduced in the appendix to the petition at A-1.

STATEMENT OF THE CASE[4]

The petitioners opened a securities brokerage account with Smith Barney in 1985 under the name T & A Research and Development Employee Benefit Plan. App. Vol. I, p. 55. Ms. Hegenbart acted as petitioners' stockbroker. App. Vol. I, p. 141. If petitioners placed an order, Ms. Hegenbart filled the order and received a commission; otherwise, she was not compensated for her advice or services. *J. Geils*, A-2, 76 F.3d at 1248. At no time was Hegenbart given discretion to trade the account; rather, petitioners retained decision-making authority. *Id.*

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3. Respondents also argued that summary judgment should have been granted in their favor since they were not fiduciaries under ERISA, and since the dispute was no longer eligible for arbitration because it was untimely. Neither the district court nor the court of appeals reached these issues.

4. The petitioners' Statement of the Case is replete with gross mischaracterizations of facts largely unsupported by citations to the record.

In May of 1985, the petitioners purchased bonds at a total cost of approximately $500,000. App. Vol. II, p. 520. In May of 1986, the petitioners sold the bonds purchased one year earlier and received approximately $696,000, net of commissions. App. Vol. I, pp. 187-190. On May 29, 1986, the petitioners paid a total of $626,436 to purchase different bonds. App. Vol. I, p. 188. The value of these bonds as disclosed on this same statement was $558,000. App. Vol. I, p. 189. A portion of the difference between the cost and the value represented the commission. App. Vol. II, p. 522. As the First Circuit found, this monthly statement "should have alerted Appellants to the possibility that fraudulent statements may have been made in connection with the bonds' value." *J. Geils*, A-23, 76 F.3d at 1258.

In June of 1985, petitioners purchased $100,000 worth of limited partnership interests in Balcor Pension Investors VI ("Balcor"). App. Vol. I, p. 186. At the time Balcor was purchased, petitioners Stephen Bladd, as Trustee or Authorized Agent, and Seth Justman, as Co-Trustee or Authorized Agent, executed a Subscription Agreement. App. Vol. I, pp. 245-247. According to the Subscription Agreement, signed under the penalties of perjury, the petitioners:

A. acknowledged receipt of the prospectus;

B. acknowledged their understanding that there was not expected to be a public market for their investment and that there were risks involved;

C. represented, if ERISA applied, that in making the investment they were aware of and had taken into consideration the diversification requirements of ERISA;

D. represented, if ERISA applied, that they concluded the investment was a prudent one;

> E. represented, if ERISA applied, that neither Shearson nor any of its affiliates was a fiduciary as defined by ERISA.

Id.

The Balcor prospectus disclosed a number of risks including that there was no public market for the limited partnership interests; the investors were unable to evaluate the mortgage loans or the partnership's performance in achieving its objectives; there were certain income tax risks; the general partner was subject to conflicts of interest; there existed the risk of defaults on mortgages which could result in losses to the partnership; the value of the properties on which Balcor held mortgages may decline for any of the reasons that real estate values decline; and no assurance could be made that the objectives of the partnership would be achieved. App. Vol. I, pp. 151-152, 155.

In September of 1985, the petitioners purchased $40,000 worth of limited partnership interests in Commercial Development Fund 85 ("CDF"). App. Vol. I, p. 186. At the time of the purchase of this investment, petitioners were given a copy of the prospectus for CDF. App. Vol. I, p. 142. CDF intended to purchase three pieces of commercial real estate at below their appraised values and dispose of them in 3 to 5 years. App. Vol. I, p. 161. There were no assurances that the partnership's objectives of preservation of capital, maximization of appreciation, or tax sheltering would be met. *Id.* The prospectus also stated that any predictions or representations which did not conform to those contained in the prospectus were not permitted. *Id.* The CDF prospectus contained many of the same risk disclosures as the Balcor prospectus. App. Vol. I, pp. 162-171.

At the time petitioners purchased Federal Insured Mortgage Investors II limited partnership in June of 1987, they were given

a copy of the prospectus for their $25,000 investment. App. Vol. I, p. 142. This prospectus also disclosed the risks associated with the investment. App. Vol. I, pp. 151-159.

Over the life of the account, each individual petitioner received a copy of the account statements on a monthly basis as did their accountant, Nick Ben-Meir. App. Vol. I, pp. 141, 183-190. These statements disclosed the transactions which occurred for the particular month as well as a summary of the portfolio. App. Vol. I, pp. 183-190. As of January of 1986, the section of the monthly statement that listed the limited partnerships carried the following legend: "the face amount does not necessarily reflect current market value." App. Vol. I, p. 186. Hegenbart was aware that Ben-Meir was reviewing transactions for petitioners. App. Vol. I, p. 141-142. In 1986, Ben-Meir reviewed a limited partnership recommendation for petitioner Seth Justman; in 1988 he reviewed Justman's entire investment activity; and in 1989 he reviewed a proposed bond transaction for petitioners. *Id.* As a result of the 1988 review, Ben-Meir wrote to Justman that he had exchanged "some extremely sharp words" with Hegenbart regarding some of the figures shown in the analysis, particularly with respect to the limited partnerships. App. Vol. I, p. 145. The letter stated they were worth "far below their cost" and "strongly advise[d] [the petitioners] *not* to enter into any more of these types of investments," due to the fact that the "'loading' charges (fees and commissions *off the top*), together with their continuingly reduced value for tax purposes . . . make them unattractive." App. Vol. I, pp. 145-146 (Emphasis in original). Ben-Meir then stated that "[d]espite [Hegenbart's] repeated statements to me that she only has your best interest at heart, my instincts say otherwise, and I would urge you, once again, to request and obtain an accounting of the fees and commissions earned by Shearson and her as a result of her placing you in all these [l]imited [p]artnerships." App. Vol. I, p. 146; *J. Geils*, A-4-5, 76 F.3d at 1249.

REASONS FOR DENYING THE WRIT

I.

THERE IS NO CONFLICT IN THE CIRCUITS REGARDING THE APPLICABILITY OF THE DOCTRINE OF EQUITABLE ESTOPPEL TO ERISA CASES.

Petitioners present this case as an appropriate vehicle to construe the text of the ERISA statute of limitations relative to breaches of fiduciary duty, 29 U.S.C. § 1113, to embrace what they characterize as the federal common law doctrine of equitable estoppel. (Petition, pp. 7-8). They urge the Court to do so because they assert there is a conflict between the First Circuit "which declines to recognize the doctrine of equitable estoppel" (Petition, p. 7) and the Seventh Circuit, which, in *Wolin v. Smith Barney, Inc.*, 83 F.3d 847 (7th Cir. 1996), decided after the First Circuit's opinion, allegedly embraces the doctrine. The alleged conflict, however, does not exist since the Seventh Circuit has not applied the doctrine to an ERISA case, nor has the First Circuit expressly rejected that doctrine.

In *Wolin*, the Seventh Circuit Court of Appeals was confronted with a strikingly similar fact pattern and argument to that presented here. The plaintiffs contended that they were unsophisticated investors looking for safe and liquid investments who were led astray by their broker who purchased unsafe and illiquid limited partnerships. *Wolin*, 83 F.3d at 850. As in this case, "the prospectuses and other documents that [the broker] furnished the trustees stated in simple, lucid, prominent and unmistakable language that investments in these real estate limited partnerships were riskier and illiquid." *Id.* at 851. As in this case, the plaintiffs were presented with written documents which contradicted the broker's oral representations that the

investments were doing fine. *Id.* As in this case, the plaintiffs argued that under the fraudulent concealment doctrine the limitation period should be tolled until they received actual knowledge of the wrongdoing due to defendants' active concealment. *Id.* The Court of Appeals disagreed.

The *Wolin* court initially discussed the distinction between "the discovery rule", generally applicable in federal cases where the statute of limitations does not begin to run against prospective plaintiffs until they learn or should have learned that they were injured, and the two different doctrines applicable in cases of "fraudulent concealment". The first, "equitable tolling", "is invoked when the prospective plaintiff simply does not have and cannot have with due diligence obtained information essential to bringing a suit", as distinguished from "equitable estoppel" "[which] is invoked when the prospective defendant [makes] . . . a special effort to cover up the fraud or does something else to prevent the prospective plaintiff from suing in time, such as promising not to plead the statute of limitations as a defense." *Id.* at 852.

It is about the application of equitable estoppel to section 1113 which petitioners assert the circuits are in conflict. As petitioners articulate the doctrine, if there is post fraud active concealment—a "cover up"—of the initial fraud, the prospective plaintiff is excused from any duty of diligence. (Petition, pp. 13-14). However, the petitioners are mistaken in their assertion that the Seventh Circuit embraced the equitable estoppel doctrine with respect to § 1113. After noting the serious difficulties which the text of § 1113 presents for the application of these doctrines, the court in *Wolin* concluded:

> This brings into view the question whether a defense of equitable estoppel not limited to fraudulent concealment is either

> comprehended within Section 1113, despite the absence of a textual handle, or survives as an independent non-statutory defense to ERISA's statute of limitations. *We need not decide,* because the Plaintiffs have not argued equitable estoppel. They have argued fraudulent concealment, which is not a synonym for equitable estoppel, though it overlaps with it.

Id. at 855 (emphasis supplied).[5]

The present case is no more a straight-forward rejection of the doctrine of equitable estoppel than *Wolin* was an embracement of it. Similar to the plaintiffs in *Wolin,* the petitioners argued that the broker's alleged statements at odds with the prospectuses and monthly statements constituted active concealment which tolled the statute of limitations until they obtained actual knowledge. *J. Geils,* A-11, 76 F.3d at 1252-1253. Like the Seventh Circuit, the First Circuit Court of Appeals disagreed and went on to address the critical threshold issues which trigger equitable estoppel: what constitutes concealment and, where contradictory communications form the basis for the alleged active concealment, whether there is an independent duty of due diligence.[6] Consistent with *Wolin*, the First Circuit held that a post-fraud communication does not "conceal" if the circumstances under which it was made put the plaintiff on notice that it may be misleading.

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5. Nor does *Martin v. Consultants and Administrators, Inc.*, 966 F.2d 1078, 1096 n. 19 (7th Cir. 1992), support petitioners' position. In *Martin,* the court's footnote discussion of the implications of active concealment in construing §1113 is dicta. The case involved "self concealing wrongs."

6. Petitioners do not confront this issue, they simply allege that various acts of the respondents were sufficient to constitute active concealment. (Petition, p. 4).

In *Wolin,* the court addressed the issue stating:

> There was no fraudulent concealment here—and there was none even if the term can, contrary to what we just suggested, be stretched, even in an ERISA case with its peculiar rule governing the accrual of the claim against the fiduciary, to cover efforts to make the victim of fraud think he has lost no money rather than that there has been no fraud. To recur to an earlier point, the plaintiffs received statements from the real estate limited partnerships that showed they were losing money, and there is no securities fraud case against an ERISA trustee who is given unequivocal written notice of facts inconsistent with the fraud—the fraud under present discussion being Mackevich's efforts to reassure the plaintiffs that the investments were doing all right.

Wolin, 83 F.3d at 855-856. Likewise, in the present case the court addressed whether the monthly statements, alleged to conceal the limited partnerships' market value by listing them at their purchase price rather than at market value, constituted concealment. The court stated:

> The district court found that the monthly statements appellants received did not conceal the market value of the limited partnership, because they listed the "face amount" and included a statement that "the face amount does not necessarily reflect the current market value". The district court concluded that based on these undisputed facts appellees did not conceal the market

> value of these investments. We agree. Beginning in January of 1986, Appellants were presented every month with a reminder that the face amount did not reflect the market value. A simple phone call inquiring about the market value would have exposed the value and shed light on the wisdom of these transactions. Thus, even assuming that Appellees "concealed" the value of the limited partnership interests, Appellants were on discovery notice of the alleged concealment as early as January 1986.

J. Geils, A-22, 76 F.3d at 1258.

To summarize the conflicts issue regarding the doctrine of equitable estoppel as applied to Section 1113: The Seventh Circuit has not adopted it; the First Circuit has not rejected it; and both circuits agree that independent acts of concealment may trigger a duty of diligence separate and apart from a duty arising from the original fraud.[7]

II:

A CASE ARISING UNDER SECTION 1113 IS NOT AN APPROPRIATE SETTING IN WHICH TO "RECTIFY" ANY CONFUSION WHICH MAY EXIST IN THE FEDERAL SYSTEM GENERALLY WITH RESPECT TO THE DOCTRINE OF "EQUITABLE TOLLING".

Petitioners have urged this Court to "rectify the confusion of doctrines applicable to all statutes of limitations." (Petition, p.

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7. If the Court were to grant this petition, the correctness or validity of this latter conclusion would also be placed in issue.

10). They suggest that lurking beyond the interpretation to be given to Section 1113 is the broader issue of whether, as a general matter of federal law, a defendant who engages in "active concealment" should be estopped from raising the defense of the statute of limitations until the prospective plaintiff has "actual" knowledge of the wrong. Under the petitioners' version of this doctrine, the plaintiff gets the benefit of an actual knowledge rule without any obligation of due diligence; in effect, subjective knowledge is all that is important. It should be noted, however, that none of the cases which petitioners cite apply so sweeping a rule as petitioners suggest. *Tomera v. Gault,* 511 F.2d 504, 510 (7th Cir. 1975) (dicta: issue was whether plaintiff had sufficiently pleaded fraudulent concealment so as to avoid summary judgment); *Sperry v. Barggren,* 523 F.2d 708 (7th Cir. 1975) (dicta: issue was whether there was dispute of fact regarding plaintiff's knowledge of fraud); *Martin v. Consultants and Administrators Incorporated,* 966 F.2d 1078 (7th Cir. 1992) (dicta: issue not presented by case involving self-concealing fraud); *Robertson v. Seidman & Seidman,* 609 F.2d 583, 593 (2d Cir. 1979) (dicta: in reversing summary judgment on statute of limitations grounds court applies "should have discovered" not "did discover" test); *Dodds v. Cigna Securities, Inc.,* 12 F.3d 346, 352 (2d Cir. 1993), *cert. denied,* 114 S. Ct. 1401 (1994) (court holds plaintiff failed to plead fraudulent concealment).

Significantly, even if there is some confusion in non-ERISA cases as to the parameters of the doctrine of equitable estoppel as distinguished from the doctrine of equitable tolling, a case involving Section 1113 presents a unique problem of statutory interpretation which renders it inappropriate for resolving the broader alleged conflict. Section 1113 (2) provides in relevant part that the limitations period begins to run "three years after the earliest date on which the Plaintiff had *actual knowledge* of the breach or violation; except that in the case of fraud *or* concealment such action may be commenced not later than six

concealment such action may be commenced not later than six years after the date of discovery of such breach or violation." (Emphasis supplied).[8] Under the analysis which the petitioners propose this Court adopt, where there is active concealment (which they do not define), the statute of limitations begins to run six years after the date of actual knowledge measured by a subjective test. In the case of "fraud" unaccompanied by "active concealment", even if the fraud were of the "self-concealing" variety, an objective standard would apply. Thus, the petitioners would effectively have the Court redraft subsection 2 of Section 1113 to read: "three years after the earliest date on which the plaintiff had actual knowledge of the breach or violation; except that in the case of fraud such action may be commenced not later than six years after the date which the plaintiff in the exercise of due diligence discovered such breach or violation, and in the

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8. Section 1113 provides:

> No action may be commenced under this subchapter with respect to a fiduciary's breach of any responsibility, duty, or obligation under this part, or with respect to a violation of this part after the earlier of—
>
> (1) Six years after (A) the date of the last action which constituted a part of the breach or violation, or (B) in the case of an omission, the latest date on which the fiduciary could have cured the breach or violation, or
>
> (2) three years after the earliest date on which the plaintiff had actual knowledge of the breach or violation;
>
> except that in the case of fraud or concealment, such action may be commenced not later than six years after the date of discovery of such breach or violation.

case of 'active concealment' such action may be commenced not later than six years after actual knowledge of the breach or violation." The difficulties with such a construction are apparent. If Congress had meant the phrase "date of discovery" to mean "actual knowledge" it would have repeated those words in the "except" clause. Other difficulties with such a construction are explored at length by the opinion in *Wolin*. 83 F.3d at 849-850. Thus, even if this case presented an appropriate record for construing Section 1113, generalizations from the opinion in such a case would hardly be of assistance to courts confronted with application of tolling doctrines in cases not governed by the peculiar wording of Section 1113.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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